

Oklahoma Lottery Commission
Minutes of Meeting
Tuesday, February 21, 2006 – 1:30 p.m.

Members Present:

Mr. Orbison, Chairman
Mr. Riley, Treasurer
Ms. Ball

Mr. Charlton
Mr. Paul

Members Absent:

Mr. Norick, Vice Chairman
Dr. Dzialo, Secretary

Others Present:

Gay Tudor, Attorney General's Office
Mary Wills, Scientific Games
Penny Nicholson, OLC
Rollo Redburn, OLC

Randy Ellis, The Oklahoman
Mark Thomas, Oklahoma Press
Association

ITEM 1

Call to Order. Roll Call and Announcement of Quorum

Roll Call: Mr. Orbison, Mr. Riley, Ms. Ball, Mr. Charlton, & Mr. Paul were present. Mr. Norick and Dr. Dzialo were absent. Mr. Orbison declared a quorum.

Mr. Norick listened to the meeting via speaker phone.

ITEM 2

**Announcement of Filing of Regular Meeting Notice
and Posting of the Agenda in Accordance With the Open Meeting Act.**

Posting of Regular Meeting Notice and Agenda were confirmed, in accordance with the Open Meeting Act.

ITEM 3

Approval of Minutes of the January 17, 2006 Regular Meeting.

Mr. Charlton made a motion to approve the minutes of the meeting held on January 17, 2006. Mr. Paul seconded the motion.

Roll call: Mr. Orbison, Mr. Riley, Ms. Ball, Mr. Charlton, and Mr. Paul voted to approve the minutes. The motion was carried.

ITEM 4

Executive Director's Report

Mr. Scroggins handed out copies of the latest Combined Sales Report. He pointed out that in the six weeks since the start of Powerball and Powerplay sales totaled \$22,730,901. He noted that, as expected, sales of Powerball tickets increased as the size of the jackpot increased. Mr. Scroggins indicated that a jackpot winning ticket (worth \$365,000,00 if paid over time in an annuity, or \$177.3 million before taxes if taken as a lump sum) had been sold in

Nebraska, although the winner(s) had not yet come forward. He noted that out of thirty jurisdictions, Oklahoma was number thirteen in Powerball sales and number five in Powerplay sales. He explained that traditionally, states that start out with Powerplay initially sell more Powerplay options than those that add Powerplay at a later time. He stated that in the last Powerball drawing, Oklahoma had one winner of \$647,142, which represented a prize of \$200,000 plus an added \$447,142 share of the match five bonus pool. Oklahoma also had three \$40,000 winners (\$10,000 plus Powerplay multiplier of 4), and four \$10,000 winners. The jackpot for the upcoming drawing will be \$15,000,000. Mr. Scroggins noted that sales of Powerball tickets had decreased, partly in response to the drop in the jackpot amount and partly due to poor weather conditions.

Mr. Paul asked what the jackpot amount was when Oklahoma joined Powerball, and Mr. Scroggins replied that it was \$87 million.

Mr. Scroggins pointed out that since start-up Pick Three sales have totaled \$3.9 million. He noted that as Powerball ticket sales increased, Pick 3 sales also increased. In addition, Pick 3 sales were enhanced by the lottery's "Doubler" promotion. These two factors combined to produce the two best weeks of Pick 3 sales the lottery has had. Mr. Scroggins noted that even though a lot more prizes had been paid out over the past couple of weeks, the overall payout percentage is still 50%, which is right on target. He also pointed out the total sales figure of \$108,655,337 from start-up of the lottery through the end of week 19. Of that figure, roughly 30% (or approximately \$32.6 million) goes into the Lottery Education Trust Fund.

Mr. Scroggins reported that the 6% commission paid to Oklahoma retailers for Powerball ticket sales now totaled \$1,363,854. He stated that some retailers had expressed dissatisfaction that they would not receive a commission on large prize payouts. Mr. Scroggins reminded the Board that when the retailer commission structure was set up, it was decided that retailers would benefit more from a larger "up front" commission of 6% of sales, rather than receiving a lower sales commission and getting a bonus for selling large-prize winning tickets. Overall commissions to Oklahoma retailers for all games now total \$6,519,320. Mr. Scroggins added that as of today 1,992 Oklahoma retail locations participate in lottery sales.

Mr. Scroggins concluded his report saying that Mr. Riley would provide additional information on the Financial Report under Agenda Item 7, but he wanted to point out that the initial transfer of 30% to the lottery trust fund had been based on estimated revenue, and that an additional \$2.1 million transfer was subsequently initiated last Friday. He stated that the next transfer was scheduled to take place on April 15th.

Mr. Orbison observed that the lottery had had "a pretty good year" with \$32.6 million raised for education.

Mr. Paul commented that although a \$10 million dollar line of credit had been negotiated, to date the lottery had gotten up and running using just the \$500,000 initial allotment from the Legislature. Mr. Scroggins noted that \$200,000 had been used from the line of credit, but that it had already been repaid. Mr. Riley added that certain aspects regarding the way the Act was written might necessitate drawing funds from the line of credit at some point in the future. Mr. Scroggins told the Board that the OLC accounting department was excited to report an \$8.2 million sweep from retailer accounts for the past week's sales.

Mr. Norick asked if he could receive a copy of Mr. Scroggins report via fax. Mr. Scroggins replied that he would send him a copy.

Ms. Ball reported to the Board that Mr. Scroggins had come to Muskogee and had visited the Sadler Arts Academy and had met with area retailers and answered their questions. She stated that she appreciated Mr. Scroggins' visit and felt it was very helpful. Mr. Scroggins said he was extremely impressed with the school and with Ms. Ball's work with the children. He said that having seen Ms. Ball in the classroom, it was easy to understand why she had been honored as Oklahoma's Teacher of the Year. Ms. Ball encouraged her fellow trustees to visit a local school.

ITEM 5

Discussion, Consideration and Possible Action on Permanent Rules

Mr. Redburn gave each Trustee a copy of the proposed Permanent Rules that had been approved at the December board meeting. He reported that a Public Hearing on the Rules had been held on Friday, February 17, 2006 but no members of the public attended. He stated that Mr. Scroggins recommended a minor modification pertaining to the policy on partial pack returns. The change would allow retailers to return partial packs for credit when the Lottery Commission ends a game. Without this change, retailers could find themselves with a large number of unsold tickets that had been activated but not sold prior to the game closing. Mr. Paul asked if there was any other circumstance under which a retailer could get a refund on activated packs. Mr. Scroggins stated that the Rules already provided for return of partial packs upon termination, suspension, cancellation or revocation, or non-renewal of the retailer contract. He stated that it was an oversight that return procedures at the termination of a game had been left out of the Permanent Rules final draft. He outlined the end-of-game procedures, including notifying retailers of the date the game would end, instructing them not to activate any new packs and explaining that partial packs of activated tickets would be picked up by the retailers' sales representative.

Mr. Paul stated that he had three questions regarding the Permanent Rules. The first question pertained to why identical definitions of terms were included three times in the Rules. Mr. Redburn replied that it was a requirement of the Office of Administrative Rules that definitions be included in each chapter of the Rules.

Mr. Paul's second question pertained to retailer appeals. He expressed concern that no time frame was established for the Board to hear an appeal. Theoretically, the Board could go years without hearing an appeal, absent a court order. He asked if perhaps a sixty or ninety day time period should be specified.

Mr. Scroggins stated that a time frame had not been set on the advice of Ms. Tudor of the Attorney General's Office. Ms. Tudor explained that time frames can become difficult, particularly if the Board did not meet every month. Because all of the Board members must be present to hear appeals, it might be difficult at times to hold a hearing within a set time frame. She stated that if the Board just "sat on" an appeal for an unreasonable length of time, the retailer would have good legal grounds to challenge the Board. Mr. Paul suggested that if a time limit was set, it should be at least 90 or 120 days to allow the Board ample time to arrange a hearing. Mr. Paul reiterated his concern that the appellant be protected from waiting an unreasonable length of time to have an appeal heard. However, he stated that after hearing the rationale for the decision not to specify a time frame, he was comfortable leaving the language as is. Mr. Scroggins reassured the Board that he did not anticipate this would ever be a problem as he and the other Directors hear initial appeals and only deny retailers for very clear-cut issues, such as unpaid back taxes. Most retailers who have brought appeals to OLC have been approved after providing additional information to the commission.

Mr. Riley asked if changing this portion of the Rules would require that the whole approval process be started over again. Ms. Tudor replied the law regarding changes was not entirely clear but, in general, only a drastic change would require re-starting the approval process. She also pointed out that since this proposed change was not the result of a comment from the public, it would probably not need to go through the entire approval process again. She advised that a record be made of all reactions to public comments with a copy forwarded to the Legislature. The record should note any changes or rejection of changes based on public comment.

Mr. Orbison stated that he was comfortable either way, and would support Mr. Paul whether he chose to make a motion to include a time frame or decided not to do so. Mr. Paul said in light of the discussion and Ms. Tudor's comments he did not feel it was necessary to make an amendment to insert a time frame.

Mr. Scroggins asked if a retailer appeal hearing could be part of a regular board meeting under new business, and Ms. Tudor replied that it could be heard at a regular board meeting, but not as new business. She stated that the hearing would have to be placed on the agenda and the retailer given sufficient notice to bring witnesses and prepare the appeal.

Mr. Paul's third question pertained to the portion of the Rules for online games. Chapter 20-1-13(a) states that the prize money must be a minimum of 45% of the gross. He noted that the state law also provides a 45% prize payout in aggregate for all games. However, the Rules do not set out a similar provision for instant games in Chapter 15. He asked if this was an oversight, or if there was a reason a percentage was not mentioned for instant games. Mr. Riley reminded the Board that in discussion at a previous Board meeting he had expressed concern that the language in Chapter 20 was redundant with the Act, and was therefore unnecessary. Mr. Paul pointed out that it was not quite the same because the Act addressed the aggregate of all games, but not individual games. Mr. Scroggins suggested removing the language from the online portion of the Rules. He stated that, in theory, it would be possible to pay less than 45% in prizes for one game, and more than 45% of another game, thereby meeting the minimum aggregate of 45% of all gross sales. Mr. Riley pointed out that although last Saturday's prizes exceeded the amount of sales, year-to-date prize payouts were at 50%. At any given time they could be above or below the statutory 45% in an individual game, although the aggregate is always at least 45%.

Mr. Paul agreed with Mr. Scroggins that the best thing to do was remove paragraph (a) so all game Rules would be structured the same way. The Act, which requires an aggregate of 45% in prizes, would give the commission the flexibility to be above or below that amount in an individual game. Mr. Paul noted that the incentive for the commission was to keep prize amounts high in order to be competitive and sell more tickets, creating more revenue. Mr. Riley made a motion to strike Chapter 20-1-13 (a) and re-letter (b) through (e) by moving them up. Ms. Ball seconded the motion.

In discussion, Mr. Charlton pointed out that changing the number might be considered a substantial change requiring a re-start of the approval process. Further discussion was held regarding the intent of the Act, since it did not specify a time period for the 45% in prizes. Ms. Tudor suggested that since other portions of the Act refer to the fiscal year, and it was reasonable to assume that that was the legislature's intent regarding prize money percentages as well. Ms. Tudor requested that the motion be tabled while she researched whether or not the proposed change was substantial enough to merit re-starting the approval process.

Mr. Orbison tabled this issue pending Ms. Tudor's research and recommendation.

ITEM 6

Report, Discussion and Possible Action on Internal Controls (Mr. Riley)

Mr. Riley reported that the CPA firm that was hired to assess internal controls on the portion of the lottery operated by OLC had completed its work. Discussion had then been held about the assessment of internal controls on the portion of the lottery operated by Scientific Games. During those discussions, Scientific Games offered to undertake an assessment of their internal controls by an outside firm at their own expense.

Mr. Riley explained the difference between a type one and type two audit report. The type one report is a certification that management has represented that internal controls are in place. The type two report is prepared when a third-party accounting firm goes on the premises and verifies that internal controls are in place and working effectively. The operations of the Scientific Games are material to OLC because a large part of the lottery operation is performed by them. Mr. Riley stated that it was very beneficial to OLC that Scientific Games had agreed to undertake evaluation of their internal controls at their own expense.

ITEM 7

Presentation of Financial Report

Mr. Riley stated that each Board member had been given a copy of the financial report for the first quarter of operations. He commented that he thought it was remarkable that OLC was able to issue its first financial statement relying upon the State system, which was not designed for enterprises, and Scientific Games systems, which are entirely new to the commission staff. Mr. Riley commended the lottery staff for getting the financial report prepared so quickly.

Mr. Orbison added his commendation to the staff, and expressed thanks to Mr. Riley for his time and effort. Mr. Riley stated that he was amazed at the number of academic and theoretical accounting issues which had to be addressed with the lottery. An added complication was the fact that the lottery is actually operating two types of businesses – online games and scratch off games. He expressed his gratitude to the State of Oklahoma and to Scientific Games for their continuing help in evolving the reporting systems to make them easier for the OLC staff to work with.

Mr. Paul asked about the item under “Current Liabilities” which lists “prize reserves” of (\$25,242). He asked what the term “prize reserve” meant and why the number was in parenthesis in the liability column. Mr. Riley explained that it pertained to the two different types of business operated by the lottery. Online ticket sale are instantly visible because the figures come through the online computer system whereas scratch off ticket sales are not easily ascertainable because not all of the tickets distributed are activated and no liability is incurred until the packs are activated.

Mr. Paul then asked about the term “value of accrued and unused annual leave.” Mr. Scroggins explained that as State employees, lottery staff accrued paid annual leave. Annual leave will, at some point, either be used, transferred (if the employee leaves and goes to another State agency, or be paid out at termination. Mr. Riley explained that if a staff member resigns, retires, or is terminated the lottery commission must pay out unused annual leave and therefore must keep track of that potential liability.

Mr. Paul asked about the calculation on the Education Lottery Account line. The year-to-date showed \$18,826,000, which he observed to be exactly 30% of the total revenues. He asked if at some point the calculation of net profits might exceed 30%. Mr. Riley explained that the Act requires a transfer of proceeds 15 days after the end of the quarter, even though an accounting statement indicating the amount of the transfer might not be available that quickly. Therefore, an initial transfer was made of \$16 million dollars. As soon as the reports were completed and the numbers were finalized, an additional transfer was initiated. He added that at year end, there might be a transfer at the close of the final quarter, another transfer after the final reports are prepared, and possibly a third transfer seven months later following the audit review. He assured Mr. Paul that all revenue produced by the lottery would be transferred, as required by the Act.

Mr. Paul made a motion to adopt the final version of the financial report and to authorize appropriate personnel to publish it, as required by law. Ms. Ball seconded the motion.

Roll call: Mr. Orbison, Mr. Riley, Ms. Ball, Mr. Charlton, and Mr. Paul voted to approve the motion. The motion was carried.

ITEM 5 CONTINUED....

Discussion, Consideration and Possible Action on Permanent Rules

Ms. Tudor returned to the meeting and reported that she reviewed the Notice of Rulemaking Intent. She stated that in her opinion, the Notice was sufficient to cover the proposed addition to 429.10 regarding game ending procedure and return of activated tickets. The Notice stated that the commission would establish collection criteria and certain requirements for retailers, etc., which is language broad enough to include the proposed change.

Ms. Tudor stated that the question regarding clarification of prize percentages is more problematic and probably not covered under the Notice. A member of the public reading the proposed rules might not come forward with questions or comments after reading the "minimum 45% prize" clause. Removing that clause might cause the public to question why the change was made.

Mr. Paul suggested that the language regarding minimum prizes be left unchanged in order to avoid possible problems with the approval process. He added that the language could be subject to amendment and/or clarification at a later time, if deemed necessary by the Board.

Mr. Orbison agreed, noting that the Act would always prevail over the Rules, so any questions arising about prize percentages would be governed by the Act. Mr. Paul agreed and withdrew his previous motion under Item 5 above.

Mr. Riley then made a motion to add language, upon the director's recommendation, within the specific time frames established by the OLC as part of an official game ending procedure, as part of Rule 429 10-1-5F 2, renumbering three and four. Mr. Paul seconded the motion.

Roll call: Mr. Orbison, Mr. Riley, Ms. Ball, Mr. Charlton, and Mr. Paul voted to approve the motion. The motion was carried.

ITEM 8

New Business

There were no items of new business.

ITEM 9

Adjournment

Mr. Paul reminded the Board that the audit committee would have its second meeting prior to the next board meeting on March 21st at 11:00 a.m. at the OLC office. The committee planned to meet subsequently in June and August, and those two meetings would include the outside auditors.

Mr. Charlton asked Mr. Orbison about establishing the retailer committee. Mr. Orbison agreed that it was now time to do so. He indicated that he would welcome input from the Board and that he planned to work closely with Mr. Scroggins to select members for the committee. Mr. Scroggins stated that he and Mr. Orbison had agreed the committee should contain a broad mix of retailers, from large corporate enterprises to small "mom and pop" stores. He also stressed the need to have balanced geographic representation on the committee. Mr. Riley agreed, and added that he felt retailers who have training programs in place for their staff should be favored over retailers who did not, as training programs were a key component in retailer performance. Mr. Scroggins offered to research staff recommendations and then meet with Mr. Orbison to discuss possible appointees. Mr. Orbison stated he would present the information to the full Board for their suggestions and input before making a final decision.

Mr. Paul asked Mr. Scroggins how he felt the lottery could best prepare to go to “the next level.” Mr. Scroggins replied that research with focus groups indicated the importance of keeping games fresh and new. He pointed out the positive effect on sales during the recent “Doubler” promotion for Pick 3. He stated that Powerball was also a key factor in the sales of Pick 3 tickets, as sales generally increase for games like Pick 3 when the Powerball jackpot becomes larger. He added that the OLC staff was also researching other online game concepts. He also indicated there would be ongoing efforts to recruit new retailers and assist current retailers with increasing their sales.

Mr. Charlton expressed thanks to Scientific Games for working so diligently with OLC staff to make the lottery a success.

Mr. Riley inquired about the establishment of super centers and placement of vending machines. Mr. Scroggins reported that two retailers with locations all around the state had indicated interest in becoming super retailers. Procedures, such as how to maintain confidentiality when sharing information on withholding child support, are being worked out. He reported that PATs (vending machines) were in the process of being manufactured and would be deployed soon in the types of locations where they have proven to work well, such as grocery stores.

Mr. Orbison asked Mr. Scroggins if the Board was in compliance with all the requirements of the Act. Mr. Scroggins replied that he believed the commission was in compliance on reporting. He stated that some issues, such as the method for funding programs to assist compulsive gamblers were pending. Another issue to be addressed was the policy regarding minority retailer participation and requirements associated with that.

Mr. Orbison announced that the next meeting would be held on March 21st at the lottery headquarters.

Mr. Paul made a motion to adjourn the meeting. Mr. Riley seconded the motion.

Roll call: Mr. Orbison, Mr. Riley, Ms. Ball, Mr. Charlton, and Mr. Paul voted to approve the motion. The motion was carried and meeting adjourned.

George Charlton, Acting Secretary

James Orbison, Chairman